to become more disciplined and businesslike in their negotiations with doctors and hospitals. According to the doctors and hospitals with whom we spoke, Anthem Blue Cross Blue Shield in Connecticut was perceived to "run a tighter ship" and Blue Cross of California was perceived to be "tough and aggressive" in its contracting.

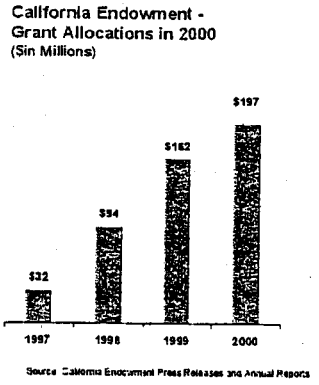
Due to the way medical care and its financing has evolved, a tension has developed between doctors and health plans. The intensity of this tension varies from region to region and from situation to situation. In California, Blue Cross of California's relationship with doctors appears to have been strained. In Connecticut, Anthem Connecticut's relationship with doctors appears less strained. The situational variability suggests the nature of the doctor/health plan relationship may depend more on the local practices, policies, and perspectives of physicians and health plans than on health plan corporate form (i.e., non-profit or for-profit) or health plan scale.

- Service to Hospitals and Doctors – Based on our discussions with doctors and hospitals in the markets studied, the health plans' service to doctors and hospitals generally appears to be at or above the levels of their major competitors.

- *Brokers of Health Insurance* who were interviewed generally report they have seen the changed Blues plans become stronger in the marketplace, because not only can the groups buying insurance depend on the continued strength of the Blue Cross Blue Shield brand, but also rates are more predictable and service has improved. Many brokers stated that they also have experienced improved service themselves.

Community - The for-profit conversion of CareFirst would cause Public Benefit Obligation foundations to be established and funded by the proceeds of the sale of CareFirst. Based on experience in other states, the combined funding for these foundations would likely be substantial. The conversion of 12 other Blue Cross Blue Shield plans in the U.S. has led to the creation of foundations currently worth a total of $6.2 billion. Foundation Boards provide the opportunity to use the funds for a variety of unmet health care needs for citizens and health care institutions of the region. Many foundations target funding to increase access to health care, as well as to enhance the quality of care in their regions. In California, one of two foundations, the California Endowment, distributed $197 million in 2000: Examples of the causes supported include:

Example of Foundation Activity



Examples of Grants Awarded
(FY2000)

Access
CPCA Ventures — $5MM
- To provide access to affordable and culturally competent primary and preventive health care clinics to low-income and medically underserved populations

Community Health Group, Kaiser, Sharp Health — $1.6MM
- To decrease the number of uninsured children and families in CA by providing subsidized coverage for children not eligible for existing programs due to immigration status

Health & Well-being
CA Dental Association Research Fund — $6MM
- To support the efforts to improve the oral health of residents in 13 urban and rural cities through the fluoridation of their water systems

Multicultural Health
Alameda Health Consortium — $2MM
- To develop and test a community clinic-based approach for reducing ethnic disparities in health status

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Other examples of foundation activity include:

- Earlier this year, the California HealthCare Foundation granted $2.5 million over two years to subsidize health insurance through the state's Managed Risk Medical Insurance Program for Californians who cannot obtain coverage in the individual health insurance market.
- A Foundation for a Healthy Kentucky gave $1 million to the University of Kentucky to endow a chair for rural health, and $1 million to the University of Louisville to endow a chair for urban health.

- The Caring for Colorado Foundation awarded $1.4 million in grants to 21 urban and rural community healthcare projects in August 2001. These grants range from human services and emergency facilities in Conifer, to a hospital in Durango, to the purchase of a mobile health van for migrant farm workers and the homeless in Weld County, to technology for a clinic serving low-income, Latino families in Denver.
- The Commonwealth Health Research Fund recently announced more than $825,000 in competitive grants to 13 medical and health researchers at public and private colleges across Virginia.
- The Anthem Foundation of Ohio provided $250,000 in funding to establish a new community dental clinic for low-income families.

According to the articles announcing the WellPoint – RightCHOICE merger, the transaction created nearly $900 million in value for the Missouri Foundation for Health, a dramatic increase in the funding for that state's health access and quality improvement programs.

The power of these foundations rests not just with their size, but also with the fact that they are singularly focused on pursuing their health care mission. To maintain federal tax-exempt status, they are required to spend a certain amount of their assets each year on activities related to their mission. In most instances, this results in a foundation granting at least 5% of its holdings towards that mission annually. We are not aware of any non-profit health plan able to spend as much of its assets on such community causes, due to the intense competitiveness of the health insurance industry. As noted by David Pockell, former CEO of Kaiser Permanente's Northern California region, one of the largest non-profit health plans and now the Director of Programs for the California Health Care Foundation: "Tax-exempt organizations in health care struggle to balance the demands of a competitive marketplace with providing social value. With for-profit plans that have converted from not-for-profit status, it is sort of like the separation of church and state. Rather than trying to thrive as a business and also satisfy the level of social mission expected of a non-profit, converted plans focus more singularly on running a business, while most of the social mission is fulfilled by the resulting foundation. The 'for-profit and foundation' structure is one way to clarify the mission of each entity."

Given national and local trends regarding increased costs, required investments and competitive pressures, now appears to be a good time for CareFirst to continue to pursue increased scale through merging with another plan and accessing public equity markets. This approach could enhance CareFirst's ability to thrive so it can continue to serve and satisfy its constituents' needs over the longer term, and could benefit the communities in which CareFirst conducts business.

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Assessment of Health Coverage Industry Trends and CareFirst's Strategic Response

Appendix

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Health Plans Being Squeezed

- Health Plans Expand & Access Equity
- National Trends Playing Out in Mid-Atlantic Region
- CareFirst Must Gain Substantial Scale & Access Capital
- Timing Appears Favorable for CareFirst to Act
- CareFirst's Constituents Likely to Benefit

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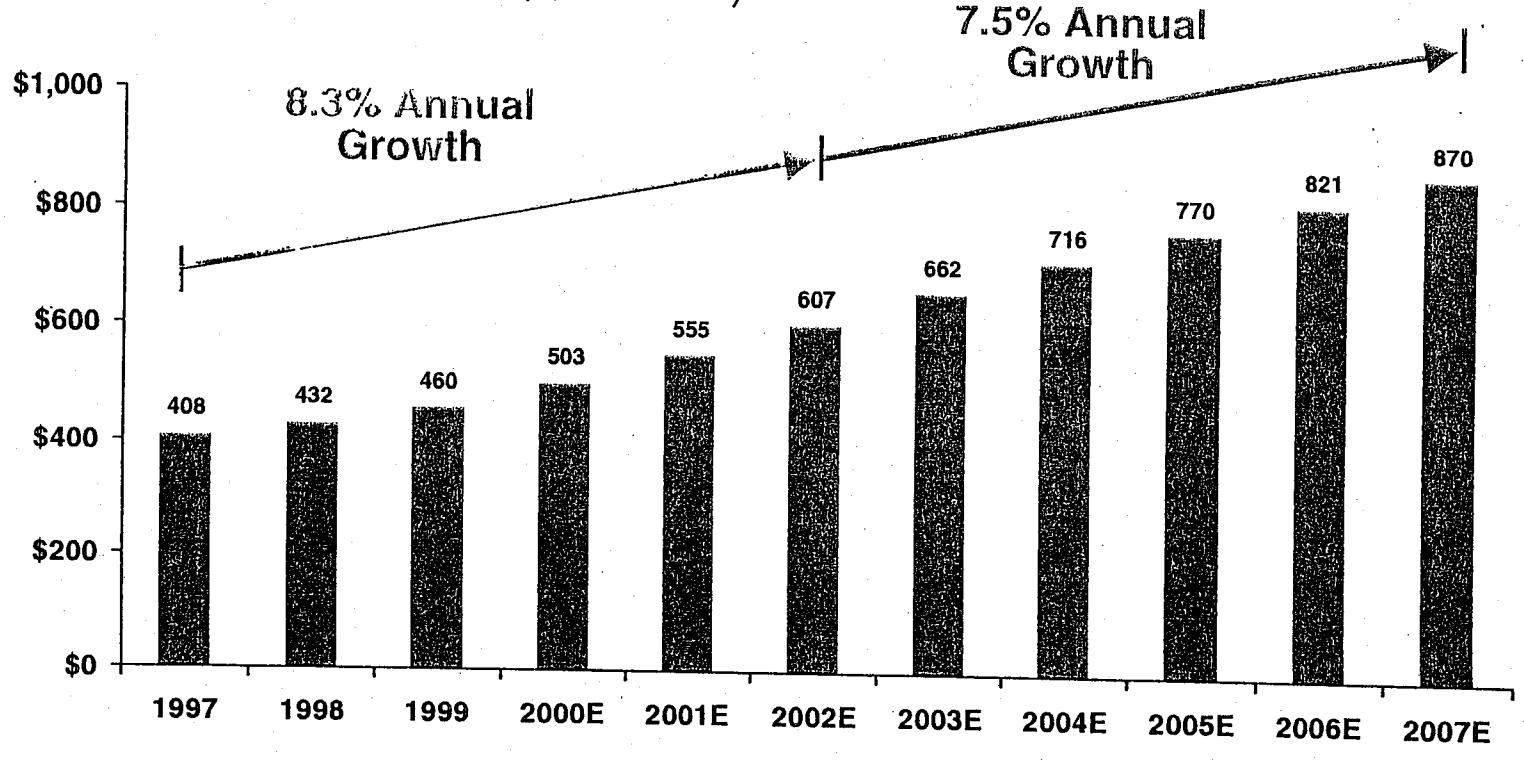
According to government estimates, from 1997 through forecasts for 2002, private healthcare costs have increased nationally an average rate of 8.3%, and will continue to increase.

Private Healthcare Expenditures

(Excluding Research & Construction, $ in Billions)



Source: Centers for Medicare & Medicaid Services (formerly Health Care Financing Administration), *National Health Expenditure Projections, 1998-2010*, March 2001

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